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No. 445

In the Supreme Court of the United States

OCTOBER TERM, 1949.

BROWN SEED COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

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No. 445

BROWN SHOE COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23-26) is reported in 10 T. C. 291. The opinion of the Court of Appeals for the Eighth Circuit (R. 149-160) is reported in 175 F. 2d 305.

JURISDICTION

The judgment of the Court of Appeals was entered on June 17, 1949 (R. 161). The petition for rehearing of the petitioner, Brown Shoe Company, Inc., filed on August 1, 1949 (R. 163-166), was

denied on August 8, 1949 (R. 167). The petition for a writ of certiorari was filed on November 5, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

QUESTIONS PRESENTED

1. Whether the court below properly held that the petitioner was not entitled to include in its equity invested capital for the taxable years 1942 and 1943 the amount of $971,031.01, representing the total amount of cash and property other than cash contributed to it by certain community groups, either as "a contribution to capital" under Section 718(a)(1) and (2) of the Internal Revenue Code, or as "accumulated earnings and profits as of the beginning of such taxable year" under Section 718(a)(4) thereof.

2. Whether the court below properly held that the petitioner was not entitled to a deduction in each of the taxable years on account of depreciation under Section 23(l) and (n), Section 113(a) and (b) and Section 114(a) of the Code on shoe factory buildings and equipment to the extent that they were contributed to the petitioner or acquired through the use of cash contributions, made to it in prior years by various communities in which such factories and equipment were situated.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 13-21.

STATEMENT

The facts were stipulated (R. 27-34), and were found by the Tax Court (R. 23-25). So far as material here, they may be summarized as follows, record references being to the stipulation:

The petitioner is a New York corporation, having its principal place of business in St. Louis, Missouri. It filed its returns for the fiscal years ended October 31, 1942, and 1943, with the Collector for the First District of Missouri. (R. 27.)

At all times material here, the petitioner was engaged in the manufacture and sale at wholesale of shoes and conducted its manufacturing operations in Missouri, Illinois, Indiana and Tennessee (R. 27-28).

In the years 1914 to 1939, inclusive, the citizens of various communities in these states contributed an aggregate amount of $885,559.45 in cash and $85,471.56 in property to the petitioner for the purpose of constructing and operating shoe factories there (R. 28-29).

(a) *The Invested Capital Issue*

The Commissioner disallowed the petitioner's claim that the total amount of $971,031.01 of money and property contributed by the various community groups was includible in its equity invested capital (R. 13). Accordingly, the Commissioner reduced the petitioner's equity invested capital for each of the fiscal years ended October 31, 1942, and 1943, by the amount of $971,031.01, representing

the contributed cash and the value of the contributed buildings (R. 31).

The Tax Court sustained the Commissioner's determination in this respect (R. 24-25). On the petitioner's appeal, the Court of Appeals affirmed the Tax Court's decision on this issue (R. 160).

(b) *The Depreciation Issue*

The cash received was deposited by the petitioner in its general bank account and debited to cash on the debit side of its ledger (R. 30). The cash received by it from particular groups was not earmarked for, or held intact and applied against the, cost of the factory, machinery, equipment, or other items applicable to the plant acquired or constructed in the particular community. In every instance, the cash received by the petitioner from community groups, as above stated, was less than the amount expended by it for the acquisition or construction of the factory building and the machinery of such factory. (R. 31.)[1]

In determining the amount of depreciation to be disallowed for the fiscal years ending 1941, 1942, and 1943, attributable to the assets acquired with contributed cash, the Commissioner first deter-

[1] Exhibit 18-R (R. 113), attached to the stipulation, is typical of the journal entries from petitioner's books reflecting the receipt by it of cash from the citizens of Sullivan, Illinois, together with entries reflecting the construction of the petitioner's new plant there (R. 31). The petitioner received $100,000 in cash from the citizens of Sullivan (Ex. 11-K (R. 29, 85-93)) and spent more than $50,000 in addition to this amount in the construction of the new factory there (R. 113-114).

mined the total cost to the petitioner of the factory building, the land (in instances where land was purchased by it), and the machinery, and then allocated the cash contribution received by the petitioner from citizens or particular communities to the cost of the buildings, land (in instances where land was acquired), and machinery in the ratio of the total cost of each of such items to the aggregate cost of all of them for the particular factory.[2] (R. 31-32).

The Commissioner disallowed deductions on account of depreciation claimed by the petitioner to the extent of $22,472.60 on contributed property, i.e., in amount of $85,471.56, and on property acquired with contributed funds, i.e., in the amount of $885,559.45, above referred to (R. 13).

The Tax Court reversed the Commissioner's de-

[2] Attached to the stipulation, marked Exhibits 1-A to 16-P, inclusive (R. 35-109), are the contracts which the taxpayer entered into with citizen groups of each community (R. 28). Thus Exhibits 1-A and 2-B (R. 35-39) are the contracts with the citizens of Charleston, Illinois; Exhibits 3-C and 4-D (R. 41-53), the contract with the citizens of Mattoon, Illinois; Exhibit 5-E (R. 53-63), the contract with the citizens of Union City, Tennessee; Exhibits 6-F and 7-G (R. 65-69), the contract with the citizens of Salem, Illinois; Exhibit 8-H (R. 71-73), the contract with the City of Litchfield, Illinois; Exhibit 9-I (R. 75-77), the contract with the citizens of Vincennes, Indiana; Exhibit 10-J (R. 79-83), the contract with the citizens of Moberly, Missouri; Exhibit 11-K (R. 85-93), the contract with the citizens of Sullivan, Illinois; Exhibits 12-L and 13-M (R. 95-99), the contract with the citizens of Pittsfield, Illinois; Exhibit 14-N (R. 101-103), the contract with the citizens of Caruthersville, Missouri; Exhibit 15-O (R. 105-107), the contract with the citizens of Charleston, Missouri, and Exhibit 16-P (R. 108-109), the contract with the citizens of Murphysboro, Illinois.

termination only in so far as he had disallowed the deductions for depreciation in respect of buildings and machinery purchased by the petitioner with such contributed cash in the amount of $885,559.45, as stated. The reason assigned by the Tax Court therefor is that the cash received by the petitioner was deposited in its general checking account and "was not earmarked for or held intact and applied against the cost of the factory, machinery, equipment or other items applicable to the plant acquired or constructed in the particular community" (R. 25), and that it therefore paid for the buildings and machinery out of its own unrestricted funds. Accordingly, the Tax Court concluded that those buildings and machinery had a cost to the petitioner, as shown on its books and records, and that it was entitled to depreciation thereon (R. 26). On the Commissioner's appeal, however, the Court of Appeals reversed the decision of the Tax Court on this issue (R. 160).

The Tax Court, however, affirmed the Commissioner's determination that the petitioner was not entitled to depreciation on the property (other than cash) which had been contributed to it of a value of $85,471.56 (R. 25); and, on the petitioner's appeal, the Court of Appeals affirmed the decision of the Tax Court on this issue (R. 160).

ARGUMENT

1. The court below was correct in holding that the petitioner is not entitled to a deduction on ac-

count of depreciation in each of the taxable years 1942 and 1943 on the buildings which were contributed to it or on buildings and equipment acquired with cash contributed to it for that purpose. The decision is in accord with principles announced by this Court and applied in other cases by the lower courts. No conflict among the circuits is alleged, and, we submit, none exists. See *Detroit Edison Co. v. Commissioner*, 319 U. S. 98; *Commissioner v. Arundel-Brooks Concrete Corp.* 152 F. 2d 225 (C.A. 4th); *C. L. Downey Co. v. Commissioner*, 10 T. C. 837, affirmed, 172 F. 2d 810 (C.A. 8th); *McKay Products Corp. v. Commissioner*, 9 T. C. 1082, 1091-1095, pending on petition for review in the Court of Appeals for the Third Circuit.

In the *Detroit Edison Co.* case, *supra*, the taxpayer contended that the payments received by it from prospective customers upon applications for construction of line extensions constituted "contributions to capital" within the meaning of Section 113(a)(8)(B) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, or "gifts" within the meaning of Section 113(a)(2) of that Act, and hence that its basis should be the same as it would be in the hands of the transferor. Reliance was also placed by the taxpayer in that case upon Article 113(a)(8)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, which provided that in respect of property acquired by a corporation after De-

cember 31, 1920, from a shareholder as "paid-in surplus, or from any person as a contribution to capital," the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. Those contentions were rejected by this Court which said: "The statutory provision that the 'basis of property shall be the cost of such property' (§ 113(a)) normally means * * * cost to the taxpayer." 319 U. S. at 102. The Tax Court in the *McKay Products Corp.* case, *supra*, similarly rejected the contention made there that the buildings received by the taxpayer constituted a gift under Section 113 (a)(2) of the Internal Revenue Code. See 9 T. C. 1082, 1094-1095.

The petitioner's contention in the present case (Pet. 21), that the buildings transferred to it and the payments made to it for the construction and equipping of factories were "gifts" or "contributions to capital" within the meaning of Section 113(a)(2) and Section 113(a)(8)(B) of the Internal Revenue Code (Appendix, *infra*, p. 13), is accordingly contrary to settled principles.

2. The court below was likewise correct in holding that petitioner, in the computation of its excess profits tax liability, was not entitled to include in its equity invested capital as a "contribution to capital" under Section 718(a)(1) and (2) of the Code (Appendix, *infra*, pp. 16-17), the amount of